Commonwealth of Massachusetts
State Ethics Commission

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CONFLICT OF INTEREST OPINION
EC-COI-93-24

FACTS:

You are a member of a law firm (Firm). You have been asked to consider an appointment as a Commissioner of the State Ethics Commission (Commission).

The Firm, which previously functioned as a partnership, has been organized and operated as a professional corporation under G.L. c. 156A. The Firm is identified as a professional corporation on its letterhead. All lawyers are instructed to include the phrase "a Professional Corporation" whenever the firm name is used, for example, on all pleadings in court and on opinion letters. All lawyers have been provided with business cards which identify the Firm as a professional corporation.

There are currently forty-six stockholders of the Firm. Under the by-laws, each stockholder is referred to as a "member of the firm" or "member." Each member holds one share of voting stock and each member has one vote on any matter which is put to a vote. As a member of the Firm, you own one share of voting stock.

The Board of Directors, known as the Management Committee, consists of four people, each of whom must be a member of the Firm. The Management Committee manages the business of the firm, except for those matters reserved to the members by the by-laws, or by the Articles of Incorporation, or to the Compensation or Nomination Committees, as provided in the by-laws. The Management Committee generally meets weekly to consider matters relating to the management of the Firm. You are a director of the Firm and sit on the Management Committee. Your term expires in January, 1994.

Each member is an officer of the Firm. There are three named officers of the Firm: a president, a treasurer and a clerk. You are an officer only by virtue of your status as a member of the Firm. The Chair of the Management Committee is ex officio the president and treasurer, but, according to the by-laws, those titles are not to be used, except as required by law, by the articles of incorporation or as requested by third parties.

The Firm is a going concern which keeps careful account of its income and assets. The Firm is also careful to observe all of the corporate formalities required by law, by the articles of incorporation or the by-laws, and keeps its records in accordance with those formalities. Its financial statements are reviewed annually by Price Waterhouse. It is adequately capitalized, and each member has paid capital into the Firm.

Members, together with associate lawyers and staff, are employees of the Firm. Annual salaries for members are set by the Compensation Committee. The distribution to the members of net receipts (profits) of the Firm is determined by the Compensation Committee, not the Management Committee. The Compensation Committee is elected by the members. Neither you nor any member of the Management Committee sits on the Compensation Committee.

On occasion, members of the Firm or associate lawyers (who are not members) represent people or entities on matters within the jurisdiction of the Commission. In particular, there is at least one member and one associate whose clients have matters currently pending before the Commission. These lawyers' practices are such that they frequently represent clients who have matters within the jurisdiction of the Commission.

If appointed to the Commission, you personally will not represent any client on matters within the Commission's jurisdiction. If appointed, as soon as you are informed that a matter pending in the Commission involves a client of the Firm, you will recuse yourself from future participation in that matter. In addition, for all

such matters, you will make arrangements within the Firm to assure that you receive no compensation related to the representation.

QUESTION:

What limitations will G.L. c. 268A place on your activities and those of the Firm and its members and employees should you accept membership on the Commission?

ANSWER:

You and the Firm will be subject to the following limitations.

DISCUSSION:

1. Jurisdiction

If you accept appointment as a Commissioner you will be a special state employee[1/] for purposes of G.L. c. 268A. *See EC-COI-87-39*. As a result, certain of the provisions of the conflict of interest law will apply less restrictively to your private activities than if you were a full-time state employee.

2. Limitations on Your Private Law Practice

a. Section 4

Section 4(a) of G.L. c. 268A, the conflict of interest law, prohibits a state employee from directly or indirectly receiving or requesting compensation from anyone other than the commonwealth or a state agency, in relation to any particular matter in which the commonwealth or a state agency is a party or has a direct and substantial interest. Section 4(c) prohibits a state employee from acting as agent or attorney for anyone other than the commonwealth or a state agency for prosecuting any claim against the commonwealth or a state agency, or as agent or attorney for anyone in connection with any particular matter in which the commonwealth or a state agency is a party or has a direct and substantial interest. "The concern addressed by §4 is the potential of influencing pending agency matters." *EC-COI-91-5*.

A special state employee is subject to the prohibitions of §4(a) and (c) only in relation to a particular matter (1) in which she has at any time participated[2/] as a state employee, or (2) which is or within one year has been a subject of her official responsibility,[3/] or (3) which is pending in the state agency in which she is serving. Clause (c) only applies to a special state employee who serves as such for more than sixty days during any period of three hundred and sixty-five consecutive days. The Commission has previously noted that a regular member of a Board or Commission has official responsibility for matters which are pending in the Board or Commission, "whether or not they have actually worked on the matter and whether or not they actually sat on the Board [or Commission] on a given day." *EC-COI-92-36* **(Board member);** *89-7* (matters pending in an agency or Commission. As a result, Commission matters that are handled by members or associate lawyers of the Firm are matters which will be the subject of your official responsibility as a Commission member. You have stated that you will not represent private persons in matters before the Commission if appointed.

Pursuant to §4(a), you will be precluded from receiving the compensation that derives from representation of a private party by members or associates of your Firm. Your proposal to have the Firm take accounting steps to ensure that you will not indirectly receive compensation in connection with such matters will prevent issues from being raised under §4(a). Section 4(a) will not prevent your from representing or receiving compensation from your or the Firm's representation of client before state agencies <u>other</u> <u>than</u> the Commission, however.

b. Section 7

This section prohibits a state employee from having a financial interest, directly or indirectly, in a contract made by a state agency, in which the commonwealth or any state agency is an interested party, unless an exemption applies. Section 7 is implicated where you will receive compensation that derives from your or the Firm's representation of a state agency client. As a special state employee, however, you may have a financial

interest in contracts made by a state agency in whose activities you neither participate nor have official responsibility for as a Commission member, following your submission to the Commission of a disclosure of the financial interest pursuant to §7(d). If appointed, you will need to follow the §7(d) exemption procedure with regard to each such representation of a state agency by you or the Firm.

3. Limitations on Your Official Activities as a Board Member

a. Section 6

This section prohibits a state employee from participating as a state employee in a particular matter in which she or a business organization in which she is an employee has a direct or reasonably foreseeable financial interest.[4/] *EC-COI-89-5; 84-96*. Thus, §6 will require your abstention from all matters in which the Firm is representing a client before the Commission.[5/] You will also be required to abstain from any decision which may result in additional legal work for the Firm. Such a situation would arise if, for example, a longtime client of the Firm was the subject of a request that the Commission institute a preliminary inquiry under G.L. c. 268B, §4. In such a case, §6 will be triggered because it is reasonably foreseeable that your vote in favor of initiating such an inquiry may result in work for the Firm. As long as you continue to abstain issues under §6 will not arise.[6/]

b. Section 23

As a state employee, you will also be subject to §23 which establishes standards of conduct for all public employees. Specifically, §23(b)(2) prohibits a public official from using her position to secure an unwarranted privilege of substantial value[7/] which is not properly available to similarly situated individuals. Under §23(b)(3) you must avoid creating the appearance of undue favoritism. Issues under these subsections could arise if you were to participate officially in a matter involving the Firm or its clients. Your intention to abstain from such matters, however, will avoid these concerns. You must also bear in mind that §23(c) will prevent you from disclosing to the Firm or its clients any confidential information which you have acquired as a Commission member.

4. Limitations on Other Members of the Firm

A partner of yours would share the restrictions which G.L. c. 268A places on the you in your private law practice. Specifically, §5(d) prohibits a partner of a state employee from acting as agent or attorney for anyone other than the state in connection with any particular matter in which the state or a state agency is a party or has a direct and substantial interest and in which the state employee participates or has participated as a state employee or which is the subject of his official responsibility.

We have concluded that all matters pending in the Commission, including those handled by members of the Firm, would be the subject of your official responsibility as a Commission member. Thus, we must address whether other "members" of the firm are your "partners" for purposes of G.L. c. 268A, §5(d).

Previously, where business ties have been indeterminate, we have construed the word "partner" broadly to include "a person who joins with another, formally or informally, in a business venture." *EC-COI-84-78; 93-9*. Thus, we have found a partnership arrangement where a group of individuals has given the public appearance of a partnership, for example, by linking their names on a letterhead and answering their telephone using this firm name, whether or not they in fact shared profits. *See, e.g., EC-COI-80-43; 82-68; 84-78*. In our decision in *EC-COI-93-9*, however, we stated that in construing the term "partner" broadly, we did not purport to "revise the terms of statutorily defined business arrangements." Thus, while we reserved the right, in appropriate circumstances, to review the substance of a corporate entity, we nevertheless recognized the distinction drawn in the language and history of G.L. c. 268A between partnerships and other forms of business arrangements. We expressly left open, however, the question whether our analysis in that case would apply to a professional corporation. *EC-COI-93-9*, n. 14.

The question left open in *93-9* is squarely presented here where the firm is organized as a professional corporation under G.L. c. 156A. Subject to the terms and conditions of Supreme Judicial Court Rule 3:06, G.L. c. 156A permits attorneys-at-law admitted to practice in the courts of the commonwealth under G.L. c. 221 to perform professional services utilizing the corporate form. G.L. c. 156A, §§2, 3.[8/] The most important feature

of Rule 3:06 is that is establishes limited liability for lawyers practicing in the corporate form. Additionally, the Rule provides that incorporation shall not diminish the application of the Code of Professional Responsibility to attorneys in the corporation; nor shall incorporation "modify, abrogate or reduce the attorney-client privilege or any comparable privilege or relationship." Although, Rule 3:06 establishes requirements for provisions that the articles of organization of each professional corporation must contain, nothing in the Rule prevents such corporations from enjoying the tax benefits and non-tax benefits enjoyed by other professional or business corporations.[9/]

In the present case, each member of the firm is a stockholder in the professional corporation and holds one share of voting stock entitling the holder to one vote on matters put to a vote in the corporation. It is well settled that "[t]he ordinary relationship of stockholders [in a corporation] is not that of partners." *Leventhal v. Atlantic Finance Corp.*, 314 Mass. 194, 198 (1944). Accordingly, unless we find a basis for disregarding the corporate form, members of the firm are not "partners" for purposes of G.L. c. 268A, §5(d).

In *EC-COI-93-9*, we expressly reserved the right to review the substance of a corporate entity according to the principles enunciated in *Evans v. Multicon Const. Corp.*, 30 Mass. App. Ct. 728, *further appellate review denied*, 410 Mass. 1104 (1991). In *Evans*, the court outlined the following twelve factors which should be considered in deciding whether to penetrate the corporate form: (1) common ownership; (2) pervasive control; (3) confused intermingling of business activity assets, or management; (4) thin capitalization; (5) nonobservance of corporate formalities; (6) absence of corporate records; (7) no payment of dividends; (8) insolvency at time of litigated transaction; (9) siphoning away of corporate assets by dominant shareholders; (10) nonfunctioning of officers and directors; (11) use of corporation for transactions of the dominant shareholders; (12) use of corporation in promoting fraud. We are mindful, however, that the general rule in this Commonwealth is that corporate form will be disregarded only in "rare particular situations to prevent gross inequity." *My Bread Baking Co. v. Cumberland Farms, Inc.*, 353 Mass. 614, 620 (1968).

We find that none of the applicable factors point in favor of piercing the corporate veil in the present case.[10/] The facts indicate that the firm is an adequately capitalized, going concern which is managed by a Board of Directors, known as the Management Committee. The Management Committee generally meets on a weekly basis. The firm is careful to observe all of the corporate formalities required by law, or by the articles of incorporation or by-laws of the corporation. Corporate records are kept in accordance with these formalities, and the financial statements of the corporation are reviewed annually by Price Waterhouse. Matched against the *Evans* factors, these facts do not warrant piercing the corporate veil that has been established by the firm's compliance with G.L. c. 156A and Supreme Judicial Court Rule 3:06.

Nor is this a case which warrants the application of the common law doctrine of partnership by estoppel which is codified in G.L. c. 108A, §16. In order to apply that doctrine it must be shown: "(1) that the would-be partner has held himself out as a partner; (2) that such holding out was done by the [would-be partner] directly or with his consent; (3) that the [party seeking to invoke the doctrine] had knowledge of such holding out; and (4) that [that party] relied on the ostensible partnership to his prejudice." *Brown v. Gerstein*, 17 Mass. App. Ct. 558, 571 (1984); *Standard Oil Co. v. Henderson*, 265 Mass. 322, 326 (1928).

Here the firm displays to the public none of the attributes of a partnership. All lawyers in the firm are encouraged to use the designation "member" or "member of the firm" when referring to stockholders, and the words "a professional corporation," when referring to the firm. The latter term appears on the firm's letterhead, business cards, pleadings and opinion letters.[11/]

Nor is the firm operated as a *de facto* partnership. Shares in the corporation are issued on the basis of "membership" and not in relation to the percentage of the profits earned or to be earned by any member. Instead, members are employees whose annual salary is set by a Compensation Committee elected by the members. Members each make a capital contribution to the corporation and all records including, presumably, the firm's tax returns reflect the corporate status. *Compare Boyd, Payne, Gates & Farthing, P.C. v. Payne, Gates, Farthing & Radd, P.C.*, 472 S.E.2d 784 (Va. 1992) (law partners who formed a professional corporation for tax purposes but who continued to conduct themselves as partners could have their rights and liabilities determined according to the law of partnership.)[12/]

Finally, we recognize that law professional corporations are distinguishable from other business or professional corporations because lawyers are subject to the professional and ethical obligations imposed by

Supreme Judicial Court Rule 3:06 and the Code of Professional Responsibility. Standing alone, however, these ethical standards do not provide a basis for disregarding the corporate form.

In essence, Supreme Judicial Court Rule 3:06 operates to remove any distinction between partnerships and professional corporations for purposes of the Code of Professional Responsibility. The Rule, however, is based not upon an interpretation of G.L. c. 156A or the principles applied to pierce the corporate veil, but upon the Supreme Judicial Court's inherent authority to regulate the practice of law. *See Opinion of the Justices*, 289 Mass. 607, 612 (1935); Post, *The Massachusetts Professional Corporation Act*, 10 Boston Bar J. 7 (1963). We conclude that this judicial authority cannot realistically be used by the Commission as a device to ignore the parties' lawful act to organize themselves as a professional corporation. *Cf. Melby v. O'Melia*, 286 N.W.2d 373 (1979) and *We're Associates Company v. Cohen, Stracher & Bloom, P.C.*, 480 N.E.2d 357 (N.Y. 1985) (both holding that the Code of Professional Responsibility applicable to lawyers practicing in the corporate form does not prevent the application for corporate law or principles of limited liability). Thus, we conclude that members of the firm are not "partners" for purposes of G.L. c. 268A, §5.[12/]

DATE AUTHORIZED: December 7, 1993

[1/]"Special state employee," a state employee:

[2/]"Participate," participate in agency action or in a particular matter personally and substantially as a state, county or municipal employee, through approval, disapproval, decision, recommendation, the rendering of advice, investigation or otherwise. G.L. c. 268A, §1(j).

[3/]"Official responsibility," the direct administrative or operating authority, whether intermediate or final, and either exercisable alone or with others, and whether personal or through subordinates, to approve, disapprove or otherwise direct agency action. G.L. c. 268A, §1(i).

[4/]Participation includes discussion and informal lobbying of colleagues, as well as voting (binding and non-binding). *EC-COI-92-30.*

[5/]The Firm has a financial interest in all matters in which it represents a client for a fee. *EC-COI-89-5*.

[6/]In general, §6 requires a state employee in addition to notify her appointing authority in writing of the financial interest. *EC-COI-85-33; 85-47*. The appointing authority shall then either: (a) assign the matter to another employee, (b) assume responsibility for the matter, or (c) make a written determination to be filed with the Commission that the interest is not so substantial as to be deemed likely to affect the integrity of the services which the Commonwealth may expect from the state employee. Here, however, the quasi-judicial nature of the Commission and the confidentiality of its proceedings, G.L. c. 268B, §4(b), make meaningful notice to your appointing authority impossible. Thus, you are advised to abstain.

[7/]Anything valued at $50 or more is "of substantial value." *Commonwealth v. Famigletti*, Mass. App. Ct. 584, 587 (1976); *Commission Advisory No. 8; EC-COI-93-14*.

[8/]Corporations not organized under G.L. c.156A, may not practice law. See G.L. c. 221, §46.

[9/]The provisions of the Massachusetts Business Corporation Law, G.L. c. 156B, applicable to ordinary business corporations, are applicable to professional corporations, except as limited by G.L. c. 156A and by professional and ethical obligations. G.L. c. 156A, §4.

[10/]Because occasions to pierce the corporate veil arise where there is (1) a "confused intermingling of the activities of two or more corporations," (e.g., where a parent and subsidiary ignore the independence of their separate corporate identities), (2) fraudulent intent or consequences arising form the acts of the principals, or (3) substantial injustice absent evasion of the corporate form, *My Bread*, 353 Mass. at 619, many of the factors discussed in *Evans* are inapplicable here.

[11/]We find no significance in the fact that aside from the designation, "a professional corporation," there has been no change in the firm name since its conversion from a partnership in 1991. *See MBA Ethics Opinion 77-14*, 62 Mass. L. Q. 193 (finding that a professional corporation may continue to use its former partnership name after incorporation; "this representation would not be misleading, for while the group members are not partners, they are in fact associated together as shareholders and employees of a professional corporation.")

[12/]In *Boyd*, attorneys referred to themselves as partners in internal firm manuals and in announcements sent to clients and the legal community; distributed stock in the same percentage as their entitlement to profits; failed to issue stock to a new "member" of the corporation, but allowed him to share in the profits; allowed the non-stockholding "member" to participate in firm meetings; referred to the firm as a partnership on tax returns; and executed an agreement dealing with the possibility of a tax audit in which each agreed that any tax liability shall become the responsibility of "each partner" according to his percentage of the profits.

[13/]This conclusion is consistent with Commission opinions which have found that "associates" and those having "Of Counsel" arrangements are not constrained by the requirements of §5. *See EC-COI-85-13* (associate); *89-5* (Of Counsel).